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FINANCIAL DIGEST

MONDAY, JANUARY 7, 1980 VOLUME XVII, NUMBER 1

THE DECADE BEGINS ON A SOUR NOTE

The 1980s have gotten underway on a note that, if continued, could make us all yearn for the good old days of the 1970s. In less than a week's time, the price of gold jumped by more than $170 per ounce, reflecting fears over political developments in the Middle East—not to mention the price of oil. Here at home, inflation continues to rage with only the barest signs that the pace will slow anytime soon. Interest rates are ratcheting downward, leading many to fear that the Federal Reserve has prematurely withdrawn its tight money policy. As for the U.S. economy in general, it continues to give off mixed signals, confusing economists and confounding policymakers.

Like the Russian monk, Rasputin, the expansion that got under way in April, 1975, seemingly refuses to die. To be sure, some sectors of the economy have been in their own slump for some time. For example, new domestic car sales peaked in the first quarter of 1979 at an annual pace of 9.3 million units. The rate in the ensuing six months dropped to an 8.3 million unit clip—while in the fourth quarter of 1979 sales fell further to a 7.4 million unit pace. The last time new domestic automobiles sold at this slow a pace was around midyear 1975.

Housing is another area that has been taking it on the chin for a while. After averaging a two million unit clip in 1977 and 1978, the pace of new housing starts dropped to a 1.7 million unit rate in 1979—ending up the year at a 1.5 million unit pace in the wake of the Federal Reserve's October 6 tightening of money and subsequent boost in interest rates. The behavior of these two important industries should not be overlooked as a guide to what is likely to happen in 1980: there never has been a time when housing and autos were falling that the U.S. economy managed to escape recession.

This is not to say that the entire consumer sector is on the ropes. As was the case a year earlier, the consumer seems to have gone on a buying spree around Christmastime that enabled some merchants to chalk up annual percentage gains in excess of the inflation rate. However, because of the record low savings rates that prevailed heading into the Christmas selling season, as well as the fact that buying power from current income is falling at the fastest rate it has since the recession of 1973-75, it is not likely that the buying binge of Christmas 1979 approached that of the year before.

INFLATION INFLUENCES BUYING PLANS

One of the reasons influencing consumers' decisions to buy is the inflation rate. Even though there is growing acceptance of the thought (Financial Digest—October 1, 1979), that the consumer price index overstates the rate of inflation, people nevertheless feel that the time to make major purchases is now. Advertising Age's monthly survey of consumer attitudes found about one person in five considering making a big-ticket purchase now rather than later to take advantage of current prices—even though a record high proportion (67 per cent) felt that this is not a good time to make major purchases. Plainly, it will take many months, if not years, of smaller monthly increases in the consumer price index to return consumers to their normal buying patterns.

Interestingly, when they put on their hats as business executives, people are not as mesmerized by inflation as they are in their role as consumers. The pace of new ordering for machine tools, for example, dropped in November, as did the overall level of new orders received by the nation's factories for durable goods. The nation's purchasing agents report that this trend continued into December. Only 14 per cent responding to a monthly

(continued)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures – Millions of Dollars)

	Week Ending 12/26/79	Change Since Week Ago	Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	126,794	+ 903	+10,747
Member Bank Borrowings	1,224	— 460	— 189
Float	6,968	+ 840	— 2,374
Total Reserve Bank Credit	141,458	+2,407	+10,073
Treasury Deposits with Federal Reserve Banks	3,095	+ 455	— 1,857
Currency Outside Banks	113,745	+1,404	+ 9,644
Member Bank Reserves:			
Required	43,594	— 103	+ 2,198
Excess (Deficiency)	555	+ 436	+ 507
Total Reserves Held	44,149	+ 333	+ 2,705
Net Borrowed Reserves	589	— 893	— 645
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	77,809	+ 361	—17,336
		r-Revised	
	12/19/79		
Money Supply ($ Bil., SA) M1	379.6	— 0.3	+5.2%
Money Supply ($ Bil., SA) M2	947.2	+ 0.9	+8.2%

NEW YORK MONEY MARKET

Offering Rates 1/4/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.02%	11.89%	10.96%
*Federal Agencies	12.96	13.06	12.30
*Project Notes—Tax Free (46% Taxable Equivalent)	n.a.	10.37	n.a.
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	13.60	13.70	

‡Finance Company Paper—Prime		‡*Bankers' Acceptances	
5- 14 days	12.00%	Feb.	13.30%
15- 29 days	13.00	Mar.	13.20
30- 59 days	13.25	Apr.	13.10
60- 89 days	12.75	May	13.05
90-179 days	12.00	June	12.95
180-270 days	11.50	July	12.80

‡Industrial Paper—Prime		†Federal Funds
30- 89 days	13.20%	Effective Rate 14.00%
90-120 days	13.00	

‡Discount Basis. *Subject to Availability. †Estimated.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'79	$ 2,397	$ 2,330	$ 2,160
Gross National Product (1972 Dollars)*	3rd Q'79	$ 1,433	$ 1,422	$ 1,407
Percent Change, Annual Rate	3rd Q'79	3.1%	—2.3%	3.5%
Change in Consumer Prices (all urban consumers)*	Nov. '79	12.0%	12.0%	7.2%
Change in Producer Prices*	Nov. '79	15.6%	12.0%	8.4%
Civilian Employment (Thousands of Persons)†	Nov. '79	97,646	97,293	97,751
Unemployment as % of Civilian Labor Force†	Nov. '79	5.8%	6.0%	5.8%
Personal Income*	Nov. '79	$ 1,999	$ 1,978	$ 1,801
Leading Indicators Composite Index (1967=100)†	Nov. '79n	136.6	138.4	142.8
Industrial Production Index (1967=100)†	Nov. '79	151.6	152.4	150.6
Net Change in Consumer Instalment Credit†	Oct. '79	$ 2.19	$ 4.45	$ 3.38
U.S. Merchandise Trade Balance†	Nov. '79	—$ 1.42	—$ 2.02	—$ 1.37
Plant and Equipment Expenditures*	1st Q'80	$189.32(a)	$184.32(a)	$165.94
Private Housing Starts (Thousands of Units)*	Nov. '79	1,518	1,762	2,107
New Construction Expenditures*	Nov. '79n	$ 235.3	$ 238.5	$ 220.0
Total Business Inventories†	Oct. '79	$ 421.6	$ 417.3	$ 372.4
Total Business Sales†	Oct. '79	$ 299.0	$ 296.4	$ 266.7

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

SHORT TERM PAPER OUTSTANDING

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CDs Weekly Reporting Banks			
Nationwide (12/26/79)	92,372	— 600	— 4,621
New York City (1/2/80)	19,602	— 621	
Commercial Paper (12/26/79)	110,627	—1,701	+28,281

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/26/79)	155,814	+1,131	+23,397
New York City (1/2/80)	47,913	+ 770	

	Total Loans Gross Adjusted Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/26/79)	396,993	+3,735	+54,564
New York City (1/2/80)	92,289	+1,641	

SECURITY MARKETS

	Friday 1/4/80	Change Since Week Ago	Change Since Year Ago
U. S. Governments, Closing Bid Prices:			
90-Day Bills (Discount Basis)	12.10%	+ .18	+ 2.76
180-Day Bills (Discount Basis)	11.97	+ .13	+ 2.60
Longest Bills (Discount Basis)	11.12	+ .28	+ 1.57
11⅜s 12/31/81	99.25	— 12/32	
10½s 12/31/83	99.10	— 15/32	
10¾s 11/15/89	100.20	— 1-16/32	
10½s 2/15/95 (w.i.)	99.7	n.a.	
10⅜s 11/15/09	100.10	— 1-25/32	
Municipals:			
Bond Buyer—20 Bond Index* (1/3/80)	7.32%	+ .09	+ .74
Blue List Total ($ Million)	$1,021	+$ 379	+$ 236
30-Day Visible Supply ($ Million)	$1,122	+$ 82	—$ 109
Total	$2,143	+$ 461	+$ 127
Corporates:			
Moody's Aa Composite (1/3/80)	11.38%	+ .12	+ 1.91
Money Mgr.—30-Day Supply ($ Million)	$1,800	+$ 455	+$ 722
Stocks:			
Dow-Jones Averages			
Industrials	828.84	— 10.07	— 1.89
Transportation	251.31	— 1.95	+ 33.94
Utilities	106.94	— 0.10	+ 5.55
65 Stocks	296.22	— 2.64	+ 13.88
Standard and Poor's 500 Stocks	106.52	— 1.32	+ 7.39
N.Y.S.E. Composite Index	61.17	— 0.71	+ 5.76
N.Y.S.E. Avg. Daily Vol. for Week (000's)	40,508	+13,000	+13,065

*46% Taxable Equivalent 13.56%

INTERNATIONAL RATES

	Friday 1/4/80	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	14.31%	14.13%
1 month	14.44	14.50
3 months	14.56	14.63
6 months	14.44	14.50
1 year	13.13	12.94
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	n.a.	n.a.
Long Term (10 to 15 yrs.)	n.a.	n.a.
FOREIGN EXCHANGE SPOT RATES New York Opening (in dollars)		
Belgium	.03584	.03573
Canada	.8552	.8522
France	.2487	.2487
Germany	.5832	.5825
Italy	.001245	.001242
Japan	.004207	.004171
Mexico	.04378	.04382
Netherlands	.5283	.5260
Switzerland	.6317	.6265
U.K.	2.2353	2.2285

survey said new orders were better in December compared with November, while 34 per cent said bookings were worse. This compares with a report by 20 per cent that new orders were better in November than in the previous month, and 22 per cent in October.

Not surprisingly, a large number of the purchasing agents said that production conditions worsened last month. Slower output was reported by 29 per cent in December compared with 22 per cent in November and 20 per cent in October. The cuts in output are not keeping pace with the declines in new orders, since backlogs are shrinking and delivery times have begun to shorten. Some 25 per cent of the purchasing agents surveyed reported that their major suppliers are making earlier shipments while only eight per cent reported slower deliveries. This gap is the largest in at least four years. As a result, the percentage of the members reporting higher inventories in December shrank to only nine per cent compared with 16 per cent in November.

MONEY REMAINS TIGHT

Because of these efforts to trim production and cut inventories, corporate demand for money has slackened. Since the Fed moved to tighten money on October 6, commercial and industrial loans at large weekly reporting banks have grown at a 5½ per cent annual rate. By contrast, in the previous 10 weeks, these loans shot up at a 22½ per cent clip. The weekly level of C & I loans has declined more times than it has risen in the past two months, leading money-market interest rates to ratchet downward. As was pointed out several weeks ago (Financial Digest—December 10, 1979), it is this softness in the demand for money—not any sudden easing in Federal Reserve monetary policy—that has been responsible for these declines in money-market interest rates.

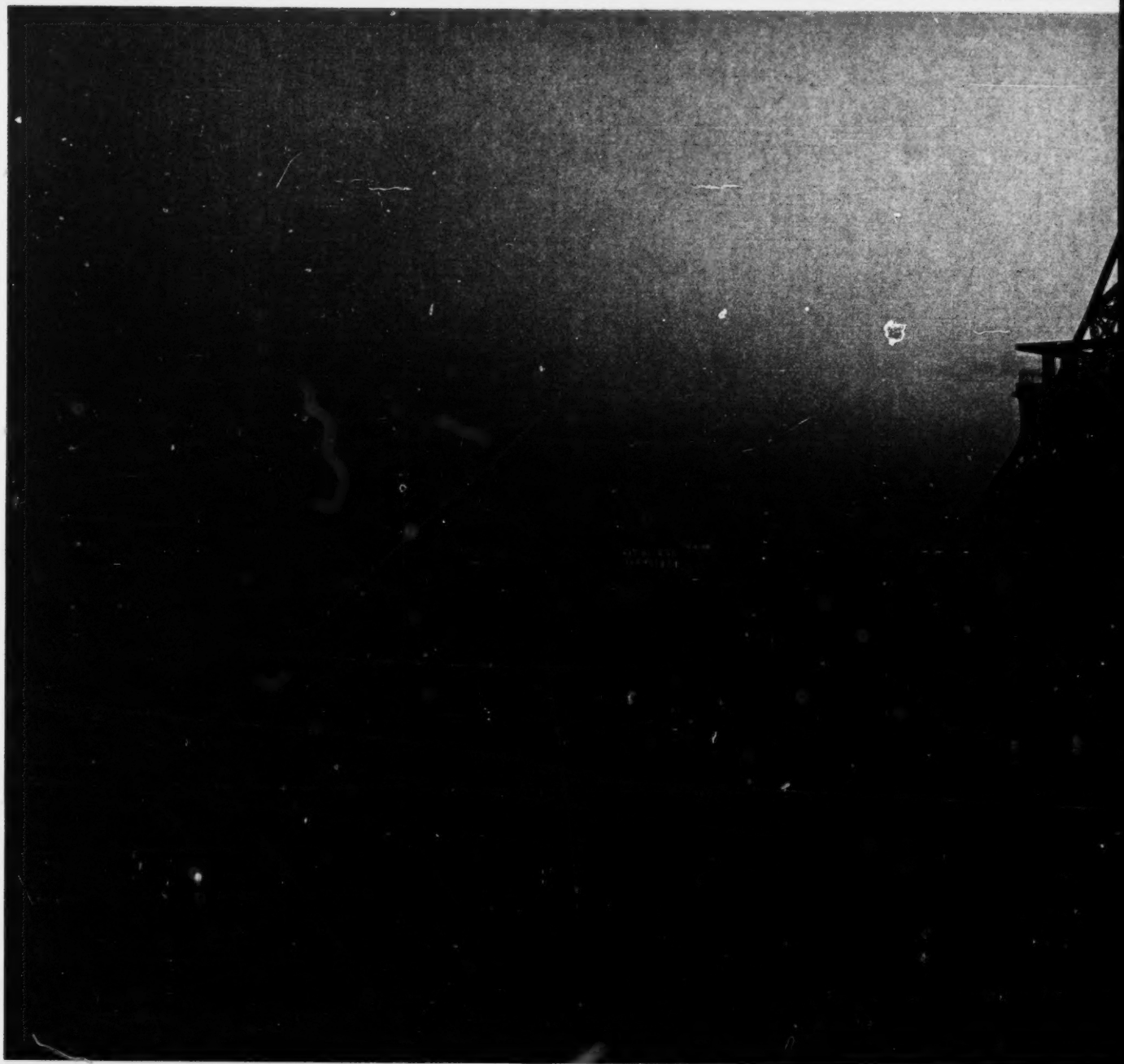
In a speech last week, Paul A. Volcker, chairman of the Federal Reserve Board, told his audience to "keep one good eye on the money supply ball." He argued that the test of monetary policy as it has been implemented since early October should be whether it succeeds in curbing growth in the money supply. By these criteria, monetary policy has, indeed, been successful. The narrowly-defined money supply, M1, is now growing far below the Fed's maximum target rate of six per cent from fourth-quarter 1978 to fourth-quarter 1979. The broader concept, M2, is also below its maximum target rate of eight per cent growth for this same time span.

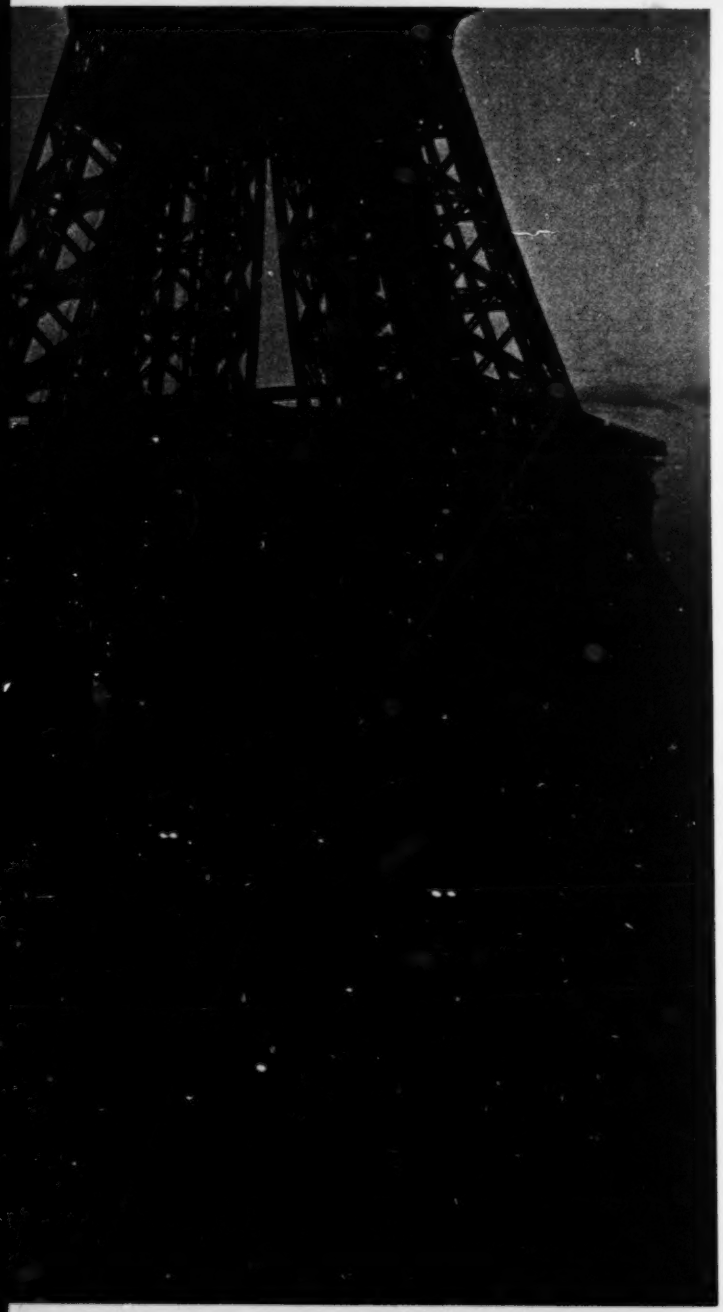
Nevertheless, if prices of gold and other precious metals continue to soar the way they have in the past few weeks, the Fed may be forced to tighten money further—even though monetary policy is about as tight as it ought to be at this time. One of the reasons why the Fed moved as it did on October 6 was to dampen speculation that was beginning to spill over into other commodities' markets in the wake of the runup in precious metals' prices that took place in late summer and early autumn. Needless to say, any further tightening of money would clearly tip the U.S. toward recession.

A TILT TOWARD RECESSION

At the moment, the economy is walking a fine line between slowdown and recession. The government's index of those indicators that measure the current pace of economic activity is running midway between the three postwar slowdowns that did not develop into recessions and the six that did. However, as one looks ahead, one must become less sanguine about the economy's ability to escape a full-fledged recession. The government's index of leading economic indicators, by virtue of its sharp decline in the past two months, now stands closer to the average of the six postwar recessions than to the average of the three postwar slowdowns. And there is yet another group of indicators that look even further ahead—in effect, leading the leading indicators—the ratio of those indicators that measure current activity to those that lag behind. According to the Commerce Department, which calculates this ratio as well as its components, this index is lower now than it ever has been in the postwar era, having fallen about as fast as it did just prior to the 1973-75 recession.

Thus, a look further out into 1980 suggests that the U.S. economy might well lapse into a full-blown recession that could turn out to be worse than the average of the six previous postwar declines.





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